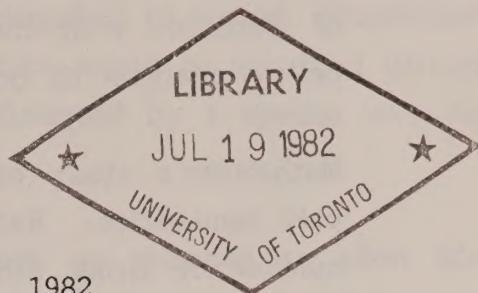




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Information, Entry and Regulation in Markets for Life Insurance, by G.F. Mathewson with John Todd, Ontario Economic Council Research Study, 117 pages, price \$7.50.

CONSUMERS NEED UNBIASED INFORMATION
ABOUT LIFE INSURANCE

TORONTO, July 14, 1982 - Consumers need more information about life insurance, and they need it in a form they can understand, says a report released today by the Ontario Economic Council. Consumer ignorance about the intricacies of life insurance policies makes it possible for insurance companies to overcharge for lower quality products and, generally speaking, younger consumers and women are the ones who lose out. The wide range of prices on policies available to these groups is evidence of this price discrimination, the report says. As well, the report says, persistent sales agents may take advantage of the consumer's ignorance and persuade people to buy too much insurance or to switch to policies that are profitable for the insurance company, but not necessarily best for the consumer.

*This report reflects the views of the authors and not necessarily those of the Ontario Economic Council or the Government of Ontario. The Council establishes policy questions to be investigated and commissions research projects, but it does not influence the conclusions or recommendations of the authors. The decision to sponsor publication of this study was based on its competence and relevance to public policy.

The report was prepared by G.F. Mathewson, Professor of Economics in the Department of Political Economy at the University of Toronto, with the collaboration of John Todd, a specialist in policy analysis of government intervention in the private market.

Mathewson's study of market structure finds no evidence of monopoly tendencies. Rather, "the industry is characterized by a large number of firms with a significant diversity of sizes". The life insurance companies do not appear to experience increasing returns to scale, nor do they appear to earn abnormally high profits. Mathewson says that consumers would be less susceptible to price discrimination if they were better informed. Public policy could create a better balance between the bargaining powers of the consumer and the life insurance companies. In addition, "governments can strengthen the legal liability of underwriting insurance firms for the advice and information offered by their agents." He suggests a number of ways in which this could be done:

- Products should be standardized. There are several ways in which the selection of life insurance products could be simplified without undermining the flexibility to meet individual needs. Standardized names could be established for policy types and riders in the same way as names for food items have been standardized. As well, policies would be priced according to the various components instead of as a complete package. The cost of the death benefit should be separate from the savings component in whole life policies; guaranteed savings should be separate from participating investment; and the commission fee to the agent should be stated separately. This would help consumers to make comparisons of the product features they want to buy. And increased competition would encourage insurance companies to offer a better rate of return on the savings component of whole life policies.
- A public information service is needed, something like those now provided by the Canadian Life and Health Insurance Association and by the Consumer Association of Canada. Unlike the former, this new service would give out information that would let consumers compare prices of different companies, and unlike the latter,

it would not have to rely on information provided voluntarily. Mathewson advocates a mandatory and publicly financed service. All life insurance companies would be required to supply information on their products, and the service, which would be provided through the provincial government, could be financed by a special levy on life insurance policies.

- The Ontario Insurance Act should be changed to allow life insurance agents to act for more than one company. Exclusive agents have no incentive to provide information on the products of other insurers, the authors say, "unless they are clearly inferior to the products which the agent is selling." Allowing independent agents to enter the market would benefit the consumer, although not all companies would use them. Big companies which have established brand names and heavy advertising commitments might still want to use exclusive agents so they can get a return on their investment. So even with independent agents, improved information would still have to be made available directly to the consumer.
- There should be a new look at the way agents are paid. Because life insurance companies pay higher commissions to agents per premium dollar for policies which are more profitable per premium dollar, there is a strong incentive for agents to sell whole life insurance. Ideally, the agent's commission should be based on how well the client is served. But since this is clearly impossible, Mathewson and Todd recommend disclosure to the consumer of the agent's commission on the sale of a policy. "For stockbrokers and real estate agents the commission appears as an explicit charge to the customer known in advance," they say, "so too should it be for life insurance."
- There should be a mandatory cooling-off period of six months for whole life policies. The 27-day cooling off period recommended by the Select Committee on Company Law of the Ontario Legislature in its 1980 report is not long enough, the authors say. In the six-month period, the consumer should be able to cancel the policy and get a refund of some of the premium paid, or have the option of converting the policy to a term insurance policy, with conversion retroactive to the original date of purchase without penalty.

- ° Some limits should be placed on the very conservative valuation rules used by most insurance companies. Instead of tying discount rates to recent rates of return on company investments, they should be linked to the market rates on long-term bonds. "This approach would force companies to adjust to major shifts in the economic environment," the authors say, "something that does not seem to happen when such changes favour insurers."
- ° Although existing government involvement in the industry offers protection for the consumer, the government's approach has been to minimize the chance of any firm failing by "encouraging the industry to behave in a way that creates a large cushion against financial trouble." The authors recommend the creation of a life insurance insolvency guarantee fund, like the deposit insurance fund used by banks, which "would provide security to individual policy-holders while freeing the regulators to allow more aggressive competition among insurance companies."
- ° If all else fails, the authors suggest that a public non-subsidized life insurance fund might be established "to provide insurance at the lowest cost compatible with good service and profitable operation." It could offer "the socially desirable levels of price, quality, information and coverage," they say, but the problem would be "to guarantee that the managers of such a public institution would pursue these objectives."

These policy proposals derive from Mathewson's analysis of economic models of the life insurance market. The analysis incorporates several important features of both consumer and firm behaviour towards life insurance. Most importantly, the study extends and refines the analysis of the effects of consumer ignorance on the trade between individual consumers and life insurance agents.

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NOTE: A list of persons to contact and biographical sketches of the authors are attached.

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John Todd is the president of Econalysis Consulting Services, Inc., a Toronto-based firm specializing in economic policy analysis. Mr. Todd has had extensive experience studying the market structure of a variety of industries including housing, securities, culture and insurance. Mr. Todd was formerly a research officer with the Ontario Economic Council.

Information, Entry and Regulation in Markets for Life Insurance is available at the following outlets:

The Ontario Government Bookstore, 880 Bay Street, Toronto, to those shopping in person. Out-of-town customers may write: Publications Section, Fifth Floor, 880 Bay Street, Toronto, Ontario, M7A 1N8, or telephone 965-6015 (toll-free long distance, 1-800-268-7540; in northwestern Ontario, 0-Zenith 67200). A cheque or money order, payable to the Treasurer of Ontario, must accompany all mail orders.

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